Bank Zachodni WBK

Weekly economic update

12 December – 18 December 2005

Contrary to earlier declarations of finance minister Teresa Lubińska, presentation of the new Convergence Program will not take place on December 10, yet only on January 10. The first reading of the 2006 budget in the Sejm did not bring any decisions. As a result, we did not received any new information on fiscal policy during the last week. Against the background of budget debate, tensions between PiS and its informal coalition partners (populist Self-defence and LPR) has heightened. Populists threatened that will stop supporting the minority government, while PiS responds that it will lead to early elections, given that recent opinion polls show high popularity for PiS and very low support for its partners.

During the nearest week we will see a few important economic indicators. They should show a picture of the economy with firmer labour market conditions, but without excessive wage pressure, and thus with good inflation outlook. Current inflation will most likely prove very low, falling again below the lower end of the allowed fluctuation band around the central bank's target. Together with appreciating zloty, low current inflation may increase willingness of some central bankers to deliver another rate cut.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (12 December)					
19:00	USA	Fed budget (U)	Nov	$bn	-61.3	-	-57.9
		TUESDAY (13 December)					
10:00	GER	ZEW index (	Dec	pts	53.0	-	-55.2
13:30	USA	Retail sales	Nov	%MoM	0.5	-	-0.1
19:15	USA	Fed meeting - decision	Dec	%	4.25	-	4.0
		WEDNESDAY (14 December)					
10:00	**POL**	**Switch bond auction (H)**					
15:00	**POL**	**CPI**	**Nov**	**%YoY**	**1.3**	**1.3**	**1.6**
15:00	**POL**	**Money supply M3**	**Nov**	**%YoY**	**13.4**	**12.2**	**8.7**
15:00	**POL**	**Foreign trade**	**Oct**	**€m**	**-305**	**-370**	**-357**
13:30	USA	Foreign trade	Oct	$ bn	-63.0	-	-66.11
13:30	USA	Import prices (U)	Nov	%	-0.3	-	-0.3
		THURSDAY (15 December)					
15:00	**POL**	**Wages**	**Nov**	**%YoY**	**3.8**	**3.8**	**6.4**
15:00	**POL**	**Employment**	**Nov**	**%YoY**	**2.2**	**2.1**	**2.1**
13:30	USA	CPI	Nov	%YoY	-0.3	-	0.2
14:00	USA	Net capital flow	Oct	$bn	80.0	-	101.9
14:15	USA	Capacity use	Nov	%	79.8	-	79.5
14:15	USA	Industrial production	Nov	%MoM	0.5	-	0.9
		FRIDAY (16 December)					
9:00	GER	Ifo index	Dec	pts	98.2	-	98.2
10:00	EMU	Final HICP	Nov	%YoY	2.4	-	-195.7
13:30	USA	Current account	Q3	%YoY	-198.0	-	2.5

* Importance level: (H)igh, (M)oderate; Source: Parkiet Reuters, BZ WBK

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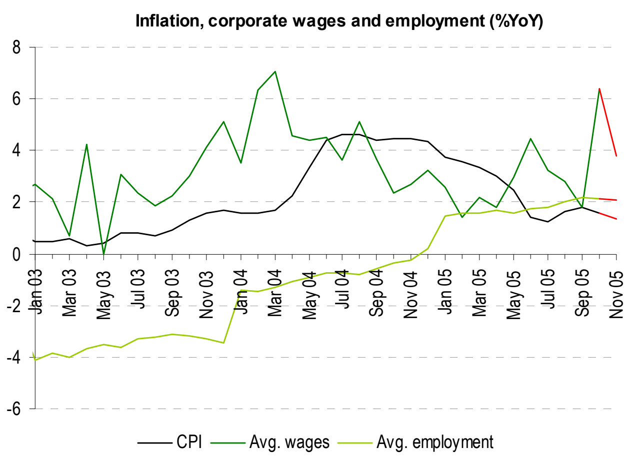
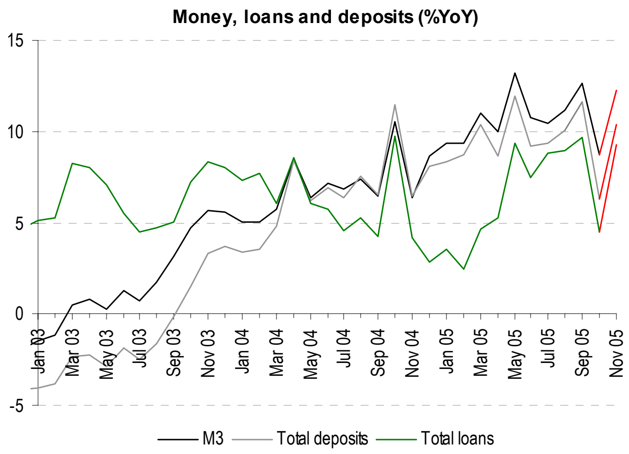
What's hot this week – A few important indicators



- Among all indicators to be published in the nearest week, inflation figures will be of high important for the market, as usual. We predict CPI inflation dropped to 1.3%YoY in November. This is lowered forecast, mostly due to lower food prices following Russian ban on Polish food export.
- Until the end of 1Q06 CPI inflation should not exceed 2%, in our opinion. Apart from events on the food market, improvement of short-term inflation forecasts results from the fact the government withdrew from hike in excise on fuels and from zloty strengthening since mid-November.
- We do not predict any threats to inflation from the side of wage pressure. We forecast that after one-off jump in wage growth to 6.4%YoY in October, it slowed down to 3.8%YoY in November. However, with solid employment rise, moderate wage growth will be enough to allow for healthy increase in wage bill, which bodes well for consumption.



- Monetary statistics, usually not attracting much attention, will be overshadowed by inflation and wage data. However, it is worth to look at them in search of hints on the strength of domestic demand.
- We forecast that growth rates of monetary statistics returned to a trend in November after one-off slowdown in October (one-off effect of high base related to IPO of the largest Poland's bank PKO BP).
- This will confirm expansion of the economy, but from the point of view of investment demand prospects it is important whether corporate borrowing will improve.
- Balance of payments statistics for October should also confirm expansion of the economy, including continuously outstanding exports performance. We estimate exports grew 14.7%YoY, a import o 14%YoY. This would mean that both external and domestic demand gains strength.

Economy last week – Budget debate began, no decisions so far

Calendar of event related to fiscal policy in Poland

Date	Event
9-14 Jan	Budget in various Sejm's committees
16-29 Jan	Budget in Public Finance Committee
10 Jan	The second reading of budget in the Sejm
10 Jan	Updated version of Convergence Program
13 Jan	The third reading of budget in the Sejm
17 Jan – 16 Feb	Budget in the Senate
15 Feb	The Sejm votes on Senate's amendments
17 Feb	The President signs the budget

- In line with expectations, although all parties in Sejm criticised the 2006 budget draft presented by the new government, the document was unanimously sent for further works to Sejm's committees.
- FinMin Teresa Lubińska said during discussion on fiscal policy in Public Finance Committee that the new Convergence Program will be presented to the European Commission on January 10. Besides, she gave no details on government's fiscal plans, only saying that the previous program was unrealistic. This suggests that the new one will no assume anymore meeting convergence criteria in 2007, yet later. Well, we will see how the European Commission will react to that.
- January will be marked by many events related to fiscal policy. Apart from consecutive steps of work over budget draft, we will then also see the new Convergence Program.

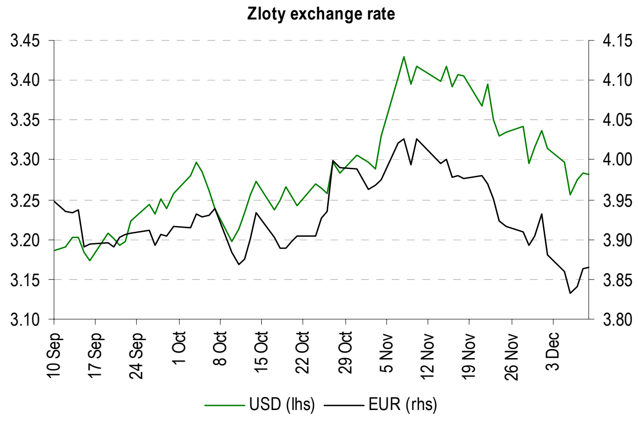
Quote of the week – Economic growth is equally important for the MPC as inflation

Stanisław Owsiak, MPC member; Reuters, 7 December

If the zloty continues to be strong, it may have a positive effect on inflation. (…) There is concern about exports because it is a sizeable component of GDP growth and even though it continues to expand its profitability is falling. (…) In the operations of the monetary policy council the inflation target is the most important target, but the view that economic growth isn't equally important to us is not justified.

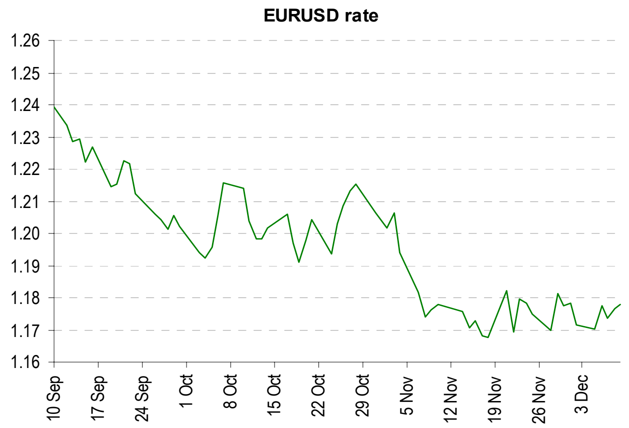
Comment from MPC member Stanisław Owsiak points out that there are such rate-setters who pay much attention to zloty exchange rate and at the same time attach similar weight to supporting economic growth as to meeting the inflation target. This suggests that if the zloty appreciation trend started in mid-November is maintained, some MPC members may become more willing to deliver another rate cut.

Market monitor



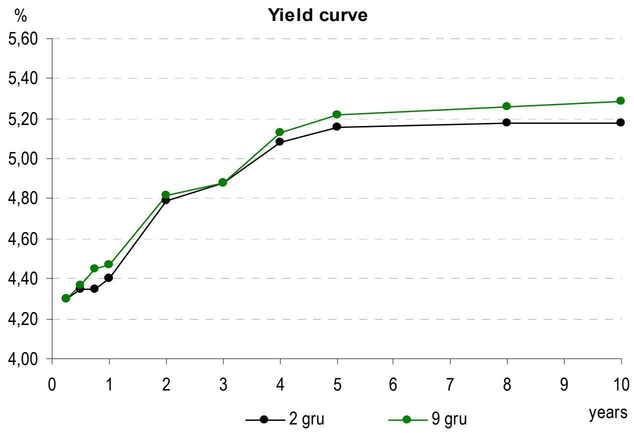
3,5 year high against the euro followed by correction

- As positive moods of investors towards our region held at the beginning of the week zloty broke important level 3.87 and strengthened to the strongest level against the euro for over 3.5 years to 3.8255 and to 3.22 against the dollar, which went along rumours MF's exchange of proceed received form foreign currency bond issues as well as new records at the WSE. After Fitch downgraded Hungary's rating the whole region experienced a correction and EURPLN went back to 3,88 though it started strengthening again. Polish currency appreciated 0.4% against the euro and 1% against the greenback within this week.
- Zloty should be strong, and 3.88-3.89 will be and important support level. We forecast EURPLN in range 3.80-3.90, whereas USDPLN 3,22-3,32.



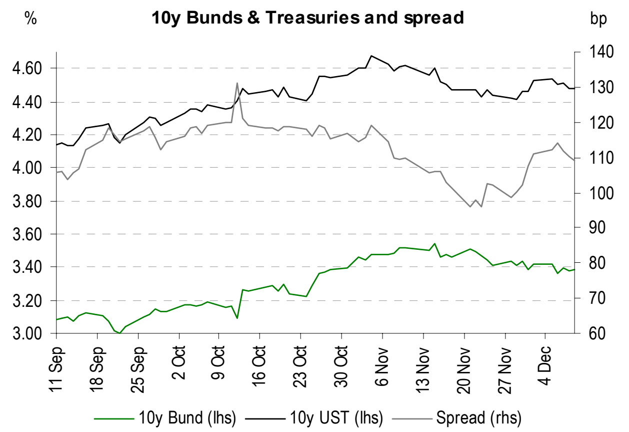
Stable EURUSD exchange rate

- EURUSD stayed in a narrow range between 1,17-1,184. The most important for the exchange rate were EBC member's statements that recent rate increase was not a start of series of rate hikes in the euro, expectation on Fed Funds rate raise amid sound economic data in U.S., as well as taking profits of long dollar positions. In the past week euro weakened by 1% from 1.17 to 1.18.
- EURUSD will be influenced by Fed rate decision as well U.S. data such as trade deficit, net capital flows, consumer prices and industrial production, which will show the prospects for the inflation pressures. In the context of slightly dovish statements of European Central Bank members the dollar should still strengthen.



Calm week on the debt market

- In the passing week the interest rate market was relatively stable. Yields rose by 3-11 bps as compared to the previous Friday with moderate activity and no substantial moves. The beginning of the week was quite calm and bond prices rose along strengthening on the core markets. However on Hungary's credit rating downgrading from A- to BBB+ by Fitch rating agency sentiment towards the region worsened and debt started weakening.
- Next week crucial CPI consumer prices index will be published and if MF's forecast at 1.2%YoY fulfils the market may strengthen. Wages and Employment figures will also matter as well as situation on the core bond markets amid ample data from U.S. and euro zone.



Cores bond markets strengthen

- Initially yields of 10Y U.S. government bonds and 10Y German Bunds rose from 4.54% to 4.57% and from 3.39% to 3,41% respectively on strong non-manufacturing ISM and PMI figures. However on release of higher than expected non-farm productivity data and lower unit labor costs as well as good auctions of 5Y and 10Y notes in the U.S., debt strengthened substantially. Yields of 10Y Treasuries fell from 4.54% at the end of the previous week down to 4.47%, whereas yields of 10Y Bunds dropped from 3.41% to 3.37%.
- In the incoming week Fed will probably increase the main interest rate in the U.S. and the market will face many important data, which may affect the yields on the core markets and market volatility.

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